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No. 84-866

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1984

VALERIA REED & MARCELLA ROULAND, CO-EXECUTORS OF THE ESTATE OF VERONICA HANCHER, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONER'S REPLY TO DEFENDANT'S MEMORANDUM IN OPPOSITION TO PETITION FOR CERTIORARI

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1. The government on page 5 of it's Memorandum argues that Petitioner has failed to show that the 1976 version of Section 2035(b)(2) allowed the annual exclusion of $3000 per donee. This argument disregards the ruling of the First Circuit in Ceppi

v. Commissioner, 698 F2d 17 which specifically held the 1976 Act allowed the annual exclusion by stating at page 20:

> "We therefore conclude that taxpayer is correct that the 1976 version of the statute allows the exclusion of the first $3000 of gifts in excess of that amount to a donee in a calendar year."

The government's argument hinges on interpreting the 1976 Act to embrace the de minimus concept. The Ceppi case rejected that interpretation and held the 1976 law enacted the subtraction out concept and allowed the $3000 exclusion in the case of gifts which exceeded that amount.

The government realizes the 1978 Technical Amendment adopted the so called "de minimus" concept which was contrary to the subtraction out concept and for this reason was not a technical or clarifying amendment but was instead a substantive change

in the law under the guise of a Technical Amendment. The opinion in the Ceppi case does not indicate that the technical and clarifying nature of the 1978 Act was brought to the attention of the Court. Had this point been raised it is doubtful if the Court would have concluded that it was the intent of Congress to make a retro-active change in substantive law under the guise of a technical amendment.

On page 7 the government again urges a construction of the 1976 Act which is contrary to the ruling of the First Circuit in the Ceppi case. Although the First Circuit specifically found there was no ambiguity in the 1976 Act the government prefaces its plea with the words "Given the ambiguity of the 1976 statute, the meaning attributed to it by the immediately succeeding Congress should be dispositive." The government cites no authority which holds that the

interpretation of the law by a "succeeding Congress" takes precedence over the decision of the First Circuit Court of Appeals. It is axiomatic that it is the responsibility of the Courts and not a subsequent Congress to interpret the law.

2. On page 5 of it's Memorandum the government argues that the language of the 1976 Act did not allow the $3000 annual exclusion because the Act spoke of an exclusion of "any gift." This argument relies on a garbled analysis of the 1976 Act. The Act does not refer to the exclusion of "any gift" instead it refers to "any gift excludable in computing taxable gifts by reason of Section 2503(b)". The Ceppi case concluded this language allowed the $3000 exclusion where the gift exceeded that amount.

On page 6 the government for the first time attempts to justify its denial of the $3000 annual exlcusion "on the basis of administrative convenience" and conjures the specter of executors investigating "every birthday gift of a handkerchief or a necktie, every wedding gift of a toaster or percolator," and even the dire responsibility of investigating "every snack given to neighborhood children by the decedent during the last three years of his life." The government fails to explain how its so called "de minimus" construction would avoid the burden of these searching inquiries by the executor. The $3000 annual exclusion refers to the accumulated gifts made by the donor to a single donee in any one year. The government's argument assumes only single gifts in excess of $3000. Three gifts of $1000 each would not exceed

the $3000 annual exclusion, however, an additional gift of $10 would, under the de minimus theory, trigger the assessment of the tax on the entire $3010. Thus under the de minimus theory advocated by the government the importance of the investigation is increased. The discovery of the gift of a $25 toaster over the $3000 exclusion under the subtraction out concept would result in an additional tax on $25. The same discovery under the government's deminimus theory would result in an additional tax on $3025. The administrative burden is the same whether the investigation is made for the purpose of determining if the $3000 is to be excluded as it is to determine if the gifts exceeded $3000.

3. On page 8 the government contends retro-active legislation which relates back to the date when a Legislative

Committee began consideration of a proposed amendment is constitutionally justifiable because the public has "ample advance notice" in the form of a report issued by the Congressional Committee. The government repeatedly refers to the "public notice" which was given concerning the report of the House Ways and Means Committee but makes no reference to the manner in which this notice was given and no reason is offered why this Court should disregard the language of Untermeyer v. Anderson 276 US 440, which specifically rejected this very concept.

4. The Defendant's Memorandum refers to Fein v. United States 730 F2d 1211 (Eighth Circuit 1984, Cert. denied, No. 84-182) and states there is no conflict between the ruling in that case and the present case. The decision in that case emphasizes that the evidence did not

indicate the donor knew about the $3000 exclusion in the 1976 Act at the time the gifts were made and the Court seemed to think this was important in arriving at it's decision. The Court in that case also relied on the decision in Ceppi v. Commissioner 698 F2d 17.

Unlike the present case, the Fein case did not require the Court to construe a technical amendment as an intention by Congress to make a retro-active change in substantive law. Nor did the Fein case require the Court to justify the arbitrary granting of relief to some but not to all of those whom Congress acknowledged were entitled to relief by its 1979 Technical Amendment.

5. Contrary to the statement on page 9 of the Defendant's Memorandum there is a conflict between the decision in the present case and that of Hemme v. United

States, number 83-5069 (S.D. IL January 23, 1985). The Hemme case held Section 2010(c) of the 1976 Tax Reform Act to be unconstitutional as applied to the facts in that case. Although the present case involved a different section of the 1976 Act the underlying issue of the constitutionality of the retro-spective application of the two sections is the same. In holding the Act unconstitutional the Court in the Hemme case relied heavily on Untermeyer v. Anderson 276 US 440, 48 S.C.T. 353, 72 LED, 645 and Blodgett v. Holden 275 US 142, 48 S.Ct. 105, 72 Led 206 and distinguished those gift tax cases from the income tax rate cases.

In the Hemme case the Court rejected the argument that the taxpayer had notice as a matter of law of the deliberations of a Congressional Committee. In the

present case the effect of the Courts ruling is to charge Mrs. Hancher with notice of the Committee's deliberation of a Technical Corrections bill which made a retro-active substantive change in the law and which was enacted almost a year after the Committee began its deliberations. In support of its ruling the Court in the Hemme CASE cited the same language from Untermeyer v. Anderson found on page 27 of the Petition For Certiorari filed in the present case.[1]

Footnote 5 page 9 of the Government's Memorandum states it has filed notice of Appeal to this Court in the Hemme case but has not yet decided whether to file a jurisdictional statement. If the government does not complete its Appeal in the Hemme case and acquiesces in the Court's ruling holding the Act unconstitutional there will be a conflict between the

1. The opinion in Hemme v. United States is reproduced in the Appendix to this Reply.

government's position in that case and the present case. Both cases involve a retro-active reduction in a gift tax exemption after the gifts were made and completely vested. The retro-active reduction in Hemme was a reduction in the combined Gift and Estate tax exemption; in the present case it was the elimination of the annual $3000 exclusion which was in effect when the gifts were made. In both cases the government attempts to justify the retro-active change in the law on the basis the taxpayer had notice that a Congressional Committee was considering a change. The Hemme case on the strength of Untermeyer v. Anderson held the taxpayer was not bound by that notice and the ruling in the present case held Mrs. Hancher was bound by that notice.

The two cases cannot be reconciled or distinguished and the same rule should apply to both taxpayers.

Petitioner respectfully prays that the Writ of Certiorari be granted.

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IN THE UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF ILLINOIS

ALVIN HEMME, DENNIS HEMME and RON HEMME, and FARMERS AND MERCHANTS BANK OF HIGHLAND, a corporation, as TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI,	)	
Plaintiffs,	)	
v.	)	No. 83-5069
UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY OF THE UNITED STATES OF AMERICA, and COMMISSIONER OF INTERNAL REVENUE,	)	
Defendants.	)	

ORDER

This is a civil action for the refund of federal estate taxes which the plaintiffs allege were erroneously assessed and collected. The parties have requested that the court make a ruling based upon the briefs filed and on stipulation of facts submitted. After hearing oral arguments the matter was taken under advisement.

On September 28, 1976, Charles W. Hirschi made gifts to five individuals totalling $45,000. In reporting these gifts on September 30, 1976 on his federal gift tax return Mr. Hirschi elected to apply the specific exemption of the then existing IRC Section 2521 in the amount of $30,000. This served to exempt $30,000 of the gifts from federal gift tax. The remaining $15,000 of gifts were also exempted by virtue of the $3,000 per donee exclusion of Section 2503(b) of the IRC.

On November 9, 1978, Mr. Hirschi died. The decedent's estate filed a timely federal estate tax return. The $45,000 worth of gifts made on September 28, 1976, were included on the return as part of decedent's estate by virtue of IRC Section 2035 which required the inclusion in the estate of gifts made in contemplation

of death. In calculating the amount of estate tax due, the estate claimed a unified tax credit in the amount of $34,000. This was the maximum unified credit then available under Section 2521 of the IRC. In auditing the estate tax return the IRS determined that the $34,000 unified credit claimed by the estate must be reduced by $6,000 because the decedent had previously used his $30,000 gift tax specific exemption in connection with his September 28, 1976 gifts. Accordingly, an assessment with respect to the disallowed amount was made against the estate and paid by the estate. The estate then filed a claim with the IRS for a refund which was denied. This suit was subsequently filed.

The Tax Reform Act of 1976 (Act), enacted October 4, 1976, adopted a single state and gift tax rate schedule. Under prior

law a donor was entitled to a specific exemption in the amount of $30,000 for gift tax purposes and the estate of decedent was entitled to a $60,000 specific exemption for estate tax purposes. The Act replaced the specific exemptions with respect to gifts made after December 31, 1976 and with respect to the estate of persons dying in 1977 and thereafter with a unified credit. The statute provided that the unified credit be phased in over a five year transaction period, beginning at $30,000 for the year 1977 and up to $47,000 for 1981 and the years thereafter. As part of the transition, Congress provided for an interim period between September 8, 1976, and January, 1977 whereby the unified credit allowed the estate would be reduced by 20% on all gifts made during the interim period where the $30,000 specific exemption was

used for gift tax purposes.

Because the decednt made his gift on September 28, 1976, which date fell within the interim period, the credit allowed Mr. Hirschi's estate was reduced by 20%. The first issue raised by the plaintiffs which we will address concerns whether the retro-active provision of 29 USC Section 2010 is unconstitutional and thus violates the due process clause of the Fifth Amendment.

The United States Supreme Court has held that Congress may provide for the retro-active operation of income tax legislation. Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87 (1938); United States v. Hudson, 299 U.S. 498, 57 S.Ct. 309, 81 L.Ed. 370 (1937); Lynch v. Hornby, 247 U.S. 339, 38 S.Ct. 543, 62 L.Ed. 1149 (1918). However, the justification for upholding retro-active income

taxation does not apply to estate and gift tax because it cannot be assumed that the taxpayer would dispose of his property in the same manner had he known the tax consequences of his act. Shanahan v. U.S., 447 F2d 1082 (10th Cir. 1971).

The case of Untermeyer v. Anderson, 276 U.S. 440, 48 S.Ct. 353, 72 L.Ed. 645 (1928) is similar to the case before us. The Revenue Act of 1924 imposed a tax on all gifts made during the calendar year of 1924 although it did not go into effect until June 2, 1924. In Untermeyer, the constitutionality of the tax as applied to a gift made on May 23, 1924, just 12 days before the Act was approved by the President was at issue. Prior to its decision in Untermeyer, the court had held the tax unconstitutional as applied to a gift made in January, 1924, on the ground that it was so arbitrary as to be a denial of due process. Blodgett v.

Holden, 275, U.S. 142, 48 S.Ct. 105, 72 L. Ed. 206 (1927). In that case the court stated that "it seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing." 48 S.Ct. at 106. In Untermeyer, the government argued that as retro-actively applied to this gift the tax was not unconstitutional because the taxpayer had ample notice of the proposed tax and in all likelihood, had made the gift at that particular time to avoid tax liability. The court rejected the argument holding the retro-active application of the tax unconstitutional. The court stated:

> The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation and practical application of the statute and render impossible proper understanding of the burden intended to be imposed. The taxpayer may justly demand to know when and how he becomes liable for taxes--he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken.
> 48 S.Ct. at 354.

There have been cases however where a retro-spective tax on an estate and gifts has been upheld. Milliken v. The United States, 283 U.S. 15, 51 S.Ct. 324, 75 L.Ed. 809 (1931); Estate of Renick v. United States,

687 F2d 371 (Court of Claims 1982). We feel these cases are distinguishable from the case at bar.

In Milliken the court held the Revenue Act of 1918 applicable to a gift made in 1916 for estate tax purposes. This holding was based on the similarity of the two statutes. The court found the only difference between the statutes was one of tax rate. The court further noted that the decedent could have anticipated the tax.

The defendant relies on the Renick decision for the proposition that the retro-spective nature of the Tax Reform Act of 1976 is not so arbitrary and capricious as to render the statute unconstitutional. In Renick, the decedent made a gift of $100,000 on December 30, 1976, two months after the enactment of the statute here in question. Because the

gift was made 2 months after the statute's enactment, the court held that the decedent was afforded a choice in determining how to handle the transaction. The court stated that "the decedent was afforded a reasonable means or choice to avoid the application of Section 2010(c) to his gift." Renick, at 377.

In the present case Mr. Hirschi had no such choice. His gift was made and his gift tax returns filed before the statute's enactment. Although the decedent taxpayer, like the taxpayer in Untermeyer, may have had notice of the proposed tax he should not be required to guess on what the legislative outcome would be.

Accordingly, we hold that the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to render it unconstitutional.

IT IS SO ORDERED:

DATED: This 23rd day of January, 1985.

/s/ WILLIAM L. BEATTY
WILLIAM L. BEATTY
UNITED STATES DISTRICT JUDGE